Supreme Court, U.S.
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In The
# Supreme Court of the United States

JEFFERSON SMURFIT CORPORATION (U.S.),

*Petitioner,*

v.

REVENUE DIVISION OF THE DEPARTMENT OF TREASURY, STATE OF MICHIGAN,

*Respondent.*

**On Petition For A Writ Of Certiorari To The Court Of Appeals Of The State Of Michigan**

## PETITION FOR A WRIT OF CERTIORARI

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## QUESTIONS PRESENTED

May a state, consistent with the Commerce Clause, impose a tax on interstate commerce that grants a deduction for new business property located within the taxing state and imposes a burden on such property located outside the taxing state?

May a state court, reviewing a Commerce Clause discrimination challenge to a state tax on interstate commerce, refuse to apply the internal consistency test developed by this Court for evaluating the constitutionality of such a tax?

## LIST OF PARTIES

The parties to the appellate proceeding in the Michigan Court of Appeals, whose decision below is sought to be reviewed, are identified in the caption of this Petition.

## RULE 29.6 STATEMENT

Petitioner, Jefferson Smurfit Corporation (U.S.), is wholly owned by JSCE, Inc., which is wholly owned by Smurfit-Stone Container Corporation, a publicly held company. No publicly held company owns 10% or more of Smurfit-Stone Container Corporation.

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## PETITION FOR WRIT OF CERTIORARI

Petitioner Jefferson Smurfit Corporation (U.S.) respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the Michigan Court of Appeals entered on November 13, 2001.

## OPINIONS AND ORDERS BELOW

The opinion of the Michigan Court of Appeals is reported at 639 N.W.2d 269 (Mich. Ct. App. 2001) and is set forth in App. 1-10. The Order of the Michigan Court of Appeals denying Petitioner's Motion for Rehearing is set forth in App. 11. The unpublished order of the Michigan Supreme Court denying Petitioner's Application for Leave to Appeal is set forth in App. 29. The transcript of oral argument and the decision of the Michigan Court of Claims is set forth in App. 12-25, and the Amended Judgment entered by the Michigan Court of Claims is set forth in App. 26-28.

## JURISDICTION

The jurisdiction of the Court is properly invoked pursuant to 28 U.S.C. § 1257(a). The decision of the Michigan Court of Appeals was entered on November 13, 2001, and that Court denied Petitioner's timely Motion for Rehearing on January 11, 2002. On December 11, 2002, the Michigan Supreme Court denied Petitioner's timely Application for Leave to Appeal.

## CONSTITUTIONAL, STATUTORY, AND REGULATORY PROVISIONS INVOLVED

This case involves consideration of U.S. CONST. art. 1, § 8, set forth in App. 30; MICH. COMP. LAWS ANN. § 208.9 (West 1998), set forth in App. 30-37; MICH. COMP. LAWS ANN. § 208.23(e) and (i) (West 1998), set forth in App. 37-38; MICH. COMP. LAWS ANN. § 208.23a (West 1998), set forth in App. 38; MICH. COMP. LAWS ANN. § 208.41 (West 1998), set forth in App. 38; MICH. COMP. LAWS ANN. § 208.45(4) and (5) (West 1998), set forth in App. 39; and MICH. COMP. LAWS ANN. § 208.45a (West 1998), set forth in App. 40.

## STATEMENT OF THE CASE

This case involves the constitutionality under the Commerce Clause of a provision of the Michigan Single Business Tax ("SBT") Act ("SBTA"), Michigan's principal tax upon business activity that was the subject of this Court's attention in *Trinova Corp. v. Michigan Dep't of Treasury,* 498 U.S. 358 (1991). The SBT provision at issue is a deduction that may be taken in calculating the tax, referred to below as the site-specific Capital Acquisition Deduction ("CAD"). The deduction is for the cost of depreciable business assets taken in the year the assets are acquired. However, only the cost of assets placed in Michigan may be considered, and the Michigan asset cost is then apportioned to Michigan. The Michigan Court of Claims held that this provision violated the Commerce Clause. The Michigan Court of Appeals reversed.

The SBT is an additive, consumption-type value added tax ("VAT"). A VAT taxes the value that a business has added to the economy, as opposed to an income tax, which taxes that which is derived from the economy. The SBT VAT taxes the consumption of resources measured by their cost. The tax base consists principally of federal taxable income, compensation paid (payroll plus fringe benefits), depreciation deducted, interest expense, royalty expense and other adjustments. *See* MICH. COMP. LAWS ANN. § 208.9 (West 1998), App. 30-37. Multistate taxpayers with business activity both within and outside of Michigan must apportion their tax base to Michigan. MICH. COMP. LAWS ANN. § 208.41 (West 1998), App. 38. During 1997, the year in issue, this was achieved by using a three-factor apportionment formula. MICH. COMP. LAWS ANN. § 208.45(5) (West 1998), App. 39. This apportionment formula may be depicted as follows: (Michigan Property/Total Property x .10) + (Michigan Payroll/Total Payroll x .10) + (Michigan Sales/Total Sales x .80) = Average Apportionment Factor.

Tax base is multiplied by the average apportionment factor to determine the "apportioned tax base." The "apportioned tax base" is adjusted for the CAD and the SBT rate

(2.3% in 1997) is applied. A simplified equation showing the calculations by which SBT liability is determined is: [Tax Base (income, compensation, depreciation, interest and royalty expense) x Average Apportionment Factor – CAD] x Tax Rate = SBT Liability

### The Status Of Petitioner And Its Operations In Interstate Commerce

Petitioner is an Illinois corporation that manufactures and sells packaging materials. In 1997, Petitioner operated 150 manufacturing plants in thirty states. Two of the plants were located in Michigan. During 1997, Petitioner placed in service $151,728,592 worth of depreciable property, of which $651,277 was placed in service in Michigan.

### The Taxes At Issue

Under MICH. COMP. LAWS ANN. § 208.23(e) (West 1998), App. 37, Petitioner was only allowed to deduct from its SBT base on its original 1997 SBT return the apportioned cost of the depreciable assets it physically located in Michigan during 1997. If Petitioner had placed all its newly employed 1997 depreciable property in Michigan, its SBT liability and the effective tax rate would have been significantly reduced. Affidavit of Jim Rau, Exhibit 2 at ¶¶ 5-6. (References to Exhibits are to those record exhibits attached to Petitioner's Brief to the Michigan Court of Appeals below). Petitioner timely filed an amended 1997 SBT return, which requested a refund of $266,786 based on Petitioner's position that the site-based CAD was unconstitutional. The Michigan Department of Treasury (the "Department") denied Petitioner's refund request.

### Prior Constitutional Litigation

When the SBTA was enacted in 1975, CAD for personal property was calculated differently than for real property. Personal property was eligible for the CAD without regard to location. The cost was apportioned to

Michigan using the proportional presence of property and payroll in Michigan compared to property and payroll everywhere. Real property was only eligible for the CAD if it was physically located in the state.

In 1989, the Michigan Court of Claims held this version of the CAD was an undue burden on interstate commerce and unconstitutional. The Michigan Court of Appeals affirmed. The Michigan Legislature then amended the CAD to eliminate the discriminatory feature, making all business property additions, wherever located, eligible for the CAD and apportioning the CAD to Michigan using the same apportionment formula as was used for the tax base. 1991 Mich. Pub. Acts 77. Thus, all business operations, whether intrastate or interstate, were treated equally. This amendment was adopted July 16, 1991 with immediate effect. After the statutory amendment, the Michigan Supreme Court granted Leave to Appeal and reversed the Court of Appeals's finding that the pre-amendment CAD violated the Commerce Clause. *Caterpillar, Inc. v. Michigan Dep't of Treasury*, 488 N.W.2d 182 (Mich. 1992), *cert. den.* 506 U.S. 1014 (1993).

**The CAD At Issue**

In 1995, at the urging of Michigan business interests, legislation was adopted amending the CAD for years beginning after December 31, 1996 to make new business property outside the state of Michigan ineligible for the deduction:

> For a tax year beginning after December 31, 1996, deduct the cost . . . of tangible assets of a type that are . . . eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes, *provided that the assets are physically located in this state for use in a business activity in this state* and are not mobile tangible assets. This deduction shall be multiplied by the apportionment factor for the year as prescribed in chapter 3.

MICH. COMP. LAWS ANN. § 208.23(e) (West 1998), App. 37 (emphasis added).

The 1995 Amendments to the SBTA represented a concerted effort by the Michigan Legislature to shift the SBTA burden from in-state businesses to out-of-state businesses. Exhibits 9 and 10. Not only did the 1995 Amendments restrict the CAD to property physically located in Michigan, they also required the Michigan asset costs to be apportioned to Michigan and placed a much higher weight on a company's sales in the three factor apportionment formula used to apportion the CAD and tax base. Exhibit 20. This meant that taxpayers with little property and payroll in Michigan (i.e., out-of-state companies) pay more SBT, while taxpayers who have greater amounts of Michigan property and payroll (i.e., in-state companies) pay less SBT. Exhibits 9 and 10. These provisions were referred to below as the "site-specific" CAD.

The House Legislative Analysis of the 1995 Amendments made it clear that the driving force behind them were "representatives of Michigan business interests." Exhibit 7 at 2. The purpose of the 1995 Amendments was to "provide[ ] tax reductions for . . . Michigan-based multistate corporations that provide high wage jobs in Michigan . . . " and to "benefit the state's economy by keeping business and industry in the state and by encouraging additional investment here." *Id.* at 3-4; Exhibit 8, Senate Fiscal Agency Bill Analysis at 4-6. Proponents of the 1995 Amendments argued that the site-based CAD "encourages manufacturers (and others) engaged in *deciding where to locate new operations* to locate in Michigan. It helps prevent Michigan-based companies from leaving the state." *Id.* at 4 (emphasis added).

The Michigan Legislature was warned in 1995 that the site-specific CAD it sought to adopt might be unconstitutional. Two memoranda dated June 14, 1995 from David White to the House Tax Policy Committee noted that "some tax experts question whether a site-based CAD is unconstitutional *because it conspicuously discriminates against out-of-state businesses.*" Exhibit 9 at 4, Exhibit 10

at 5 (emphasis added). On December 7, 1995, State Senator Peters voted against the 1995 SBTA Amendments, stating "I believe the passage of this bill is unconstitutional, in that you can't treat companies differently based on where they do their business. And yet, under this bill, that is exactly what is happening." Exhibit 6 at 2. Despite these and many other repeated warnings, the Michigan Legislature passed the site-specific CAD.

**Proceedings Below**

Petitioner filed a Complaint in the Michigan Court of Claims alleging a violation of the Commerce Clause. While Petitioner was still seeking discovery, the Department moved for summary disposition and asked the Court of Claims to grant summary disposition to Petitioner if the Court denied it to the Department.

The Court of Claims held that the CAD was unconstitutional:

> In the instant matter, in-state taxpayers are able to take advantage of the amended deduction while out-of-state taxpayers may only avail themselves of the deduction if they have capital assets physically located in the state. The effect is to channel capital investment into Michigan.
>
> Defendant maintains that it is constitutionally permissible for a state to structure its tax system so as to encourage the growth and development of intrastate commerce. However, it seems clear that such growth and development is not to be had at the expense of inhibiting interstate commerce. See *Boston Stock Exchange*, *Northwestern States Portland Cement Company*, and *Complete Auto*).

App. 21.

> The court is satisfied that plaintiff has demonstrated that the deduction fails this internal consistency test. Plaintiff has demonstrated that under this analysis a multistate taxpayer may be penalized for having operated in interstate

> commerce rather than strictly intrastate commerce. . . .
>
> The Court is of the opinion that such a burden falls directly on free trade among the states and is impermissible under the Commerce Clause. Such an effect may result in the type of economic isolation among the states which the Commerce Clause seeks to prevent. See *Oklahoma Tax Commission v Jefferson Lines Incorporated* 115 S Ct 1331, (1995) . . . The Court, therefore, is of the opinion that MCL 208.23(e), the site-based capital acquisition deduction to Michigan's single business tax, discriminates both on its face and [in] its effect on interstate commerce. Accordingly, the defendant's Motion for Summary Disposition is denied.
>
> The Court, based on the defendant's plea, will grant the motion in favor of the plaintiff and will approve an order accordingly.

App. 23-24.

The Court below reversed and held that the site-specific CAD is constitutional. After reciting the stream of amendments to the CAD since the SBTA was enacted, the Court below noted Petitioner's claims that the apportioned, site-specific CAD was facially discriminatory, had a discriminatory effect and was enacted for a discriminatory purpose. As to facial discrimination, the Court below followed the Michigan Supreme Court decision involving the initial version of the CAD. Just as that Court did in 1992 in *Caterpillar,* 488 N.W.2d at 192, the Court below held that since the CAD is available to any taxpayer, whether multistate or entirely a Michigan in-state company, the CAD was not facially discriminatory. App. 8. With regard to discriminatory purpose, the Court below ignored legislative history offered by Petitioner concerning discriminatory purpose, stating that "discussions regarding the goal of encouraging investment in Michigan fall in line with repeatedly approved intent and practice" quoting from this Court's decision in *Trinova,* 498 U.S. at 385. App. 8. With regard to discriminatory effect, the Court below held

that any harmful effects of the provision flowed not from the discrimination itself, but rather from the decision by Petitioner not to increase its Michigan investment. App. 9.

Although fully briefed and argued before both the trial court and the Court below, the Court below failed to apply the internal consistency test developed by this Court for application in a Commerce Clause discrimination case. When this failure was brought to its attention through Petitioner's Motion for Rehearing, the Court below refused to apply the test, denying without comment the Motion for Rehearing. *See* Order, App. 11.

Petitioner timely filed an Application for Leave to Appeal with the Michigan Supreme Court on February 1, 2002. On December 11, 2002 that Court, without comment, denied Petitioner's Application for Leave to Appeal. App. 29. Petitioner now submits this Petition for a Writ of Certiorari.

## REASONS FOR GRANTING THE PETITION

**Evidence in the record obtained from the Department through discovery proves that the impact of the decision below permeates the national economy.** When the challenged provision was proposed to the Michigan Legislature in 1995, Michigan's Chief Deputy Treasurer testified at a legislative hearing that out of approximately 17,000 multistate taxpayers that file Michigan SBT Returns, the 12,000 out-of-state firms would see a likely tax increase while approximately 5,000 in-state firms would see a likely tax decrease. Exhibit 11, p. 3, Table 2. The discrimination against out-of-state firms contemplated at the time the legislation was being adopted was achieved. Michigan's Deputy Revenue Commissioner testified in November of 1999 that "the Department estimates the number of multistate firms that . . . are disadvantaged are 12,000." Affidavit of David Kirvan, Exhibit A to Department's Brief to the Court below. Therefore, the national impact of letting the decision of the Court below stand is substantial and it is adverse to the Commerce Clause interest of free trade. The decision

endorses state tax legislation that provides a direct commercial advantage to local businesses and creates a preferential trade area within Michigan. Business operations that could be more efficiently conducted elsewhere are diverted from the most economically efficient channels and are directed to Michigan. The decision creates an environment in which decisions about the location and conduct of business operations are not made based upon considerations of non-tax criteria. Instead, these decisions are influenced by state tax provisions that foreclose tax neutral decision making.

**The Michigan Court of Appeals decision on this federal question conflicts with decisions of other state courts of last resort involving tax provisions that are substantially indistinguishable from the Michigan provision.** In *PPG Industries, Inc. v. Pennsylvania,* 790 A.2d 252 (Pa. 1999) (*PPG1*) and *PPG Industries, Inc. v. Pennsylvania,* 790 A.2d 261 (Pa. 2001) (*PPG2*), the Pennsylvania Supreme Court held a capital stock tax provision that allowed a deduction only with respect to manufacturing in Pennsylvania or corporate headquarters expense attributable to manufacturing in Pennsylvania was unconstitutional under the Commerce Clause. In *PPG1*, the Pennsylvania Court held:

> By employing the manufacturing exemption to the capital stock tax as a means of inducing other business operations, i.e., manufacturing to be performed in Pennsylvania, Section 602 unconstitutionally forecloses tax neutral decisions and affords preferential treatment to corporations that engage in manufacturing activities in the Commonwealth. This is the exact type of economic balkanization the commerce clause protects against. We thus agree with PPG that the manufacturing exemption to Pennsylvania's capital stock tax facially discriminates against interstate commerce.

*PPG1,* 790 A.2d at 260.

The Michigan provision challenged below likewise contains a discriminatory feature apparent from a facial

review of the statute. However, the Court below saw no facial discrimination, just as the Michigan Supreme Court in *Caterpillar,* 488 N.W.2d 182, found no facial discrimination, because "the CAD is available for any taxpayer, whether a multistate company or a company whose business activity is allocated entirely to Michigan – an in-state company." App. 8. "Here," the Court below reasoned, "the site specific CAD for real and personal property is likewise available to any and all companies doing any measure of business in Michigan. Accordingly, we conclude that subsection 23(e) is facially neutral." App. 8.

In *R.J. Reynolds Tobacco Co. v. City of New York Dep't of Finance,* 667 N.Y.S.2d 4 (N.Y. App. Div. 1997), a New York appellate court affirmed a trial court finding that a New York City income tax provision which granted a depreciation deduction for property "placed in service in New York," but disallowed a depreciation deduction if it was placed in service elsewhere, violated the Commerce Clause. This provision is the functional equivalent of the CAD upheld by the Court below. The New York Court correctly held that the provision was facially discriminatory, having the practical effect of discriminating against taxpayers doing business in New York City who have commercial property located outside of New York. The court held that "the unequal treatment of the taxpayers results solely from the situs of their activities and provides a commercial advantage to local businesses and threatens to exert an inexorable hydraulic pressure on interstate businesses to ply their trade within the State that enacted the measure rather than among the several states." 667 N.Y.S.2d at 9. The decision below, by contrast, blames the victim of the discrimination for the harm the victim suffers. The Commerce Clause injury to a multistate taxpayer that refuses to succumb to the pressure applied by the Michigan provision is said by the Court below to result from taxpayer's decision to "opt to increase activity outside Michigan. . . . Generally speaking, the overall tax consequences to a multistate taxpayer will be dependent upon the nature of his business activities and whether it is eligible and elects to avail itself of the tax reduction

incentives afforded by the SBT." App. 9-10. In saying this, the Michigan Court was parroting a similarly erroneous decision made by the Michigan Supreme Court in *Caterpillar*, 488 N.W.2d 182, which similarly blamed multistate taxpayers for any adverse tax consequences for not electing to avail themselves of the tax reduction incentives afforded by the SBT. App. 9.

**The decision below conflicts with the decisions of this Court on an important question of federal law.** If left in force, the decision below will contribute to a rupture in the fabric of Commerce Clause jurisprudence and will have nationwide deleterious ramifications. This Court has clearly held that when a state tax statute is challenged on Commerce Clause discrimination grounds, the reviewing Court must evaluate the challenged provision for internal consistency.[1] *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995). Although briefed and orally argued before both the trial court and the Court below, the Court below failed to apply or even acknowledge the existence of the internal consistency test in rendering its decision. Petitioner filed a Motion for Rehearing, explicitly and singularly reiterating its request that the Court below apply the internal consistency test. The Court below refused to do so, denying without comment Petitioner's Motion for Rehearing. App. 11. Unless this Court wishes to abandon the internal consistency test as a test of Commerce Clause validity, the Court below must be required to apply the internal consistency test, even if the action of this Court to secure that result is limited to summary reversal and a remand of this case for application of the internal consistency test.

---

[1] Although the internal consistency test is related to whether a tax is "fairly apportioned," it is also clearly implicated in determining whether a tax discriminates against interstate commerce. The "internal consistency" test "is applicable where the allegation is that a tax facially discriminates against interstate commerce." *Ashland Oil, Inc. v. Caryl*, 497 U.S. 916, 919 (1990).

**The Court need not decide the remedy in this case.** The Michigan Legislature contemplated and addressed the constitutional problem with the CAD by the adoption of the so-called "fall back" provisions, which specify the remedy to be employed by a court should the CAD be declared unconstitutional. *See* MICH. COMP. LAWS ANN. § 208.23a (West 1998); App. 38.

**The CAD Is Unconstitutional**

A state tax scheme is unconstitutional if it: (A) is facially discriminatory against interstate commerce; (B) has a discriminatory effect; or (C) was enacted for discriminatory purpose. *Amerada Hess Corp. v. Director, Div. of Taxation, NJ Dep't of Treasury*, 490 U.S. 66, 75 (1989). The CAD fails all three of these tests announced by this Court.

**The CAD Is Facially Discriminatory**

A state tax statute that "discriminate[s] between transactions on the basis of some interstate element" is facially discriminatory and unconstitutional. *Armco, Inc. v. Hardesty*, 467 U.S. 638, 642 (1984). In *Armco*, the Court struck down a tax statute that, like the site-based CAD, treated companies differently based solely upon whether the company conducted manufacturing in the taxing state. The CAD is facially discriminatory because it conditions eligibility for the deduction to "assets *physically located in this state*." *See* MICH. COMP. LAWS ANN. § 208.23(e) (West 1998); App. 37. The testimony of the Director of Tax Policy for the Office of Revenue and Tax Analysis of the Department, Howard Heideman, confirmed this discrimination. *See* Exhibit 3, at 63 ("I think the [site-based CAD] provision discriminates against multistate firms"). Petitioner offered the testimony of Professor Richard D. Pomp, a recognized expert in the field of state taxation, who stated in his affidavit that, *inter alia*, Michigan's site-based CAD is facially discriminatory. Exhibit 1 at ¶ 6.

The CAD is similar to the statute considered in *Armco, supra,* in which the Court said:

> *On its face*, the gross receipts tax at issue here appears to have just this effect. The tax provides that two companies selling tangible personal property at wholesale in West Virginia will be treated differently depending upon whether the taxpayer conducts manufacturing in the state or out of it.

*Armco, supra*, 467 U.S. at 642 (emphasis added).

Similarly, in *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269 (1988), the provision struck down made reference to the source of ethanol in qualified motor fuel otherwise eligible for an Ohio state tax credit as "produced outside Ohio" or "produced in Ohio." The Court held:

> The Ohio provision at issue here explicitly deprives certain products of generally available beneficial tax treatment because they are made in certain other states, and thus on its face, appears to violate the cardinal requirement of nondiscrimination.

*New Energy*, 486 U.S. at 274 (emphasis added).

The test of facial discrimination is not whether preferential tax treatment is available to both residents and non-residents, but whether such treatment is available regardless of the location of business activities and assets.[2] This is exemplified by *Boston Stock Exchange v. State Tax Commission*, 492 U.S. 318 (1977), ("*Boston*"), where the Court struck down a tax scheme that gave preferential tax treatment to stock sales made in New York *by both residents and non-residents*, and by *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984), where the Court struck down as facially discriminatory a tax credit *available to both residents and non-residents*.[3]

---

[2] The CAD is also facially discriminatory because it lacks internal consistency. See note 4, *infra*, and accompanying text.

[3] The credit at issue in *Westinghouse* was likewise "available" to any taxpayer, but only for shipments from a regular place of business in New York.

*See also New Energy*, 486 U.S. at 274, (tax credit struck down which was conditioned on location at which products made, not residency of taxpayer); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 268 n.8 (1984) (noting that "[t]he state does not seriously defend the Hawaii Supreme Court's conclusion that because there was no discrimination between in-state and out-of-state *taxpayers* there was no commerce clause violation.") (emphasis in original). In each of these cases, the discriminatory provision was available to in-state and out-of-state companies. The problem with each provision was that it required in-state activity. The CAD likewise requires in-state activity. Equal availability to a discriminatory benefit did not save these tax schemes from being struck down under the Commerce Clause analysis.

A state tax scheme that benefits businesses that choose to perform business activities inside the state but burdens businesses that choose to perform business activities outside the state is unconstitutional. *Westinghouse*, 466 U.S. 388. Similarly, a state tax scheme granting a reduction in taxes for sales occurring in a state but denying such a reduction for sales occurring outside the state is also invalid. *Boston*, 429 U.S. at 328. Commerce Clause jurisprudence also makes no distinction for purposes of the Commerce Clause between a tax on income or business activity and a tax only incidentally impacting interstate commercial activities, such as ownership of property used in connection with commercial activity. *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997).

In *Armco*, the Court expounded on what types of tax schemes would result in "fair encouragement of in-state business." In that case, the Court noted that it would be permissible for a state that seeks to foster manufacturing to impose a tax only on wholesaling. 467 U.S. at 645-46. Likewise, a state seeking to foster wholesaling might impose a tax only upon manufacturing. *Id.* Yet it was unconstitutional for a state to treat taxpayers differently depending on where the taxpayers conduct their manufacturing operations. *Id.* A state may structure its tax system

in an *evenhanded* manner to encourage in-state business, but a state may not seek to foster in-state business by imposing a different tax burden on the in-state and out-of-state location of business assets or activities. *See Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 878 n.6 (1985). The Court has struck down discriminatory tax statutes *precisely because* they gave an incentive for a taxpayer to locate in a state in order to qualify for favorable tax treatment. *See Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 72 (1963) ("the disparate treatment would be an incentive to locate within Louisiana.").

**The CAD Is Not "Internally Consistent" And Encourages "Economic Balkanization" Of The Nation's Markets**

In order to survive scrutiny under the Commerce Clause, a state tax must be "internally consistent" such that "the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995). The "internal consistency" test "looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared to commerce intrastate." *Id.* The CAD violates this principle and discriminates against interstate commerce. If every state enacted Michigan's SBT with its CAD, the result would be a higher aggregate tax burden imposed on an interstate business than is imposed on an intrastate business.

Professor Richard D. Pomp, Petitioner's expert witness, demonstrates that the CAD violates internal consistency. In Affidavit paragraph 15, Professor Pomp testified:

> 15. The site based CAD is also not "internally consistent." This is so because, if every state adopted the site-based CAD, then a taxpayer operating in interstate commerce would receive a CAD from only one state and that CAD would be

> apportioned, with the result that the taxpayer would receive a CAD equal to only a fraction of the value of its depreciable property. On the other hand, a taxpayer operating in intrastate commerce only would receive a CAD on the full value of its depreciable property.

This effect is demonstrated numerically by Professor Pomp's affidavit.[4]

Since the CAD is both site-specific and apportioned, a multistate taxpayer could never receive a one hundred percent deduction if every state enacted the CAD. This is so because only the state in which the property was located would allow a CAD and that CAD would be apportioned. A taxpayer operating in interstate commerce, by

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[4]

**TABLE 1**
**INTERNAL CONSISTENCY**

(Assumes that Michigan's Single Business Tax (including the site-based CAD) was adopted in all states and that both taxpayers invested in depreciable property in Michigan.)

| | **Intrastate Business A (operates solely in Michigan)** | **Interstate Business B (operates 50% in Michigan and 50% in Ohio)** | |
|---|---|---|---|
| | Michigan | Michigan | Ohio |
| Tax Base | $100,000,000 | 100,000,000 | 100,000,000 |
| Apportionment Factor | 100% | 50% | 50% |
| Apportioned Tax Base | $100,000,000 | $50,000,000 | $50,000,000 |
| CAD for Property Acquired in Taxing Jurisdiction Only: | $10,000,000 | $5,000,000 | $0 |
| Amt. On which tax is imposed | $90,000,000 | $45,000,000 | $50,000,000 |
| Tax (2.3%): | $2,070,000 | $1,035,000 | $1,150,000 |
| Total Tax in all states: | $2,070,000 | $2,185,000 | |
| **Tax Penalty for having operated in Interstate Commerce rather than Intrastate Commerce:** | | **$115,000** | |

definition, has an average apportionment factor in every state of less than 100%. On the other hand, a company that operates *only in intrastate commerce* would receive a CAD equal to the full amount of its new property. The CAD encourages businesses to engage only in intrastate commerce and to forego interstate commerce. This is precisely what the Commerce Clause forbids. In *Jefferson Lines*, the Court said that the purpose of the Commerce Clause is to "prevent[ ] a state from retreating into economic isolation or jeopardiz[e] the welfare of the nation as a whole, as it would do if it were free to place burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear. . . . The [Commerce Clause] reflects . . . the conviction that, in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization. . . . " 514 U.S. at 180. In *Boston,* the Court held that "[p]ermitting the individual states to enact laws that favor local enterprises at the expense of out-of-state businesses would invite a multiplication of preferential trade areas destructive of the free trade which the [Commerce] Clause protects." 429 U.S. at 329 (internal quotations and citations omitted). The CAD encourages economic Balkanization and therefore violates the Commerce Clause.

Director Heideman (Exhibit 3) testified: "for multistate firms . . . a deduction for Michigan investments that is multiplied by the apportionment factor provides a smaller benefit. . . . " (p. 36); and, "the capital acquisition provision . . . discriminates against all multistate companies." (p. 64). Mr. Heideman also testified that the CAD was a "departure from the theory of a value added tax," Exhibit 3 at 35-36, and that the CAD has no grounding in tax theory or tax policy. (p. 13).

The Department has not attempted to argue or demonstrate that the CAD is internally consistent. The Court of Claims specifically noted that "defendant has not addressed this argument as articulated by plaintiff." App. 23. The Department's Briefs to the Court below did not address this issue. The Department has conceded that the CAD is not internally consistent.

A state tax that is facially discriminatory can only survive constitutional challenge if it "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Camps,* 520 U.S. at 581. This is an extremely difficult burden, "so heavy that 'facial discrimination by itself may be a fatal defect.'" *Id.* (quoting *Oregon Waste Systems, Inc. v. Dept. of Environmental Quality of Oregon*, 511 U.S. 93, 101 (1994)). The Department did not attempt to argue below that the CAD had no "reasonable nondiscriminatory alternative."

**The CAD Has A Discriminatory Effect Upon Interstate Commerce Because It Reduces The Effective SBT Rate For Taxpayers Who Invest In Michigan**

In striking down the tax scheme in *Boston*,[5] the Court explained the scheme was unconstitutional because it resulted in two possible tax burdens, a higher one if a sale was consummated outside New York and a lower one if a sale was consummated within New York. 429 U.S. at 331. Thus, the tax scheme foreclosed "tax neutral decisions" and was unconstitutional. *Id.* The Court explained:

> After the amendment took effect, a nonresident contemplating the sale of securities that would be delivered or transferred in New York faced two possible tax burdens. If he elected to sell on an out-of-state exchange, the one-half rate of [the tax] applied without limitation on the total tax

[5] In *Boston*, the tax on securities transactions: (1) afforded a 50% reduction in the tax rate to transactions by nonresidents of New York when the transaction involved an in-state sale, and (2) limited the total tax liability of any taxpayer (resident or non-resident) to $350 for a single transaction involving a New York sale. The Court found that the amendment "foreclose[d] tax-neutral decisions and create[d] both an advantage for the exchanges in New York and a discriminatory burden on commerce to its sister States" in violation of the Commerce Clause. 429 U.S. at 331.

> liability; if he sold the securities on a New York exchange, the one-half rate of [the tax] applied and then only up to a $350 tax liability. Similarly, residents engaging in large block transactions on the New York exchanges were subject to a maximum tax levy of $350; but if they sold out-of-state, their tax bill would be limited only by the number of shares sold. Thus, under [the amendment] the choice of exchange by all nonresidents and by residents engaging in large transactions is not made solely on the basis of nontax criteria. Because of the delivery or transfer in New York, the seller cannot escape tax liability by selling out of State, but he can substantially reduce his liability by selling in State.

*Id.* at 331.

In *Westinghouse*,[6] the Court struck down a tax credit that lowered a taxpayer's effective tax rate as the taxpayer's subsidiary conducted a greater percentage of its shipping activities in New York. 466 U.S. at 400. The Court found that this tax credit had the forbidden effects of "foreclosing tax neutral decisions and creat[ing] an advantage for firms operating in New York by placing a discriminatory burden on commerce to its sister States." *Id.* at 406 (emphasis added).

Similar to the tax schemes struck down in *Boston* and *Westinghouse*, the CAD "forecloses tax neutral decisions,"

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[6] *Westinghouse* involved taxation of corporations operating Domestic International Sales Corporation ("DISC"). The DISC's parent corporation was taxed based upon accumulated income (*i.e.*, total receipts, expenses, assets and liabilities of both the parent corporation and DISC). The tax gave a credit equal to the gross receipts from export products shipped from a regular place of business in New York. The tax credit was enacted to "provide a positive incentive for increased business activity in New York State" and to "ensure that New York would not lose its competitive position vis-à-vis other States." 466 U.S. at 393, 397.

influences the choice of where to locate assets, and exerts an inexorable hydraulic pressure on interstate businesses to ply their trade within the state of Michigan rather than among the several states. As in *Boston*, an SBT taxpayer contemplating acquisition of depreciable property faces two possible tax burdens: a higher effective SBT rate if the property is located outside of Michigan because it cannot take a CAD for such property; or a lower effective SBT rate if the property is located in Michigan because it can take a CAD for that acquisition.[7] Exhibit 1. Given this outcome, the choice of where to locate capital assets is not made "solely on the basis of nontax criteria" as required by

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[7] The following illustration demonstrates this effect of the CAD.

**TABLE 2**

**HIGHER EFFECTIVE TAX RATE**

| | AT THE OUTSET | AFTER $100,000 MICHIGAN INVESTMENT | AFTER $100,000 OHIO INVESTMENT |
|---|---|---|---|
| Total SBT Tax Base | $1,000,000 | $1,000,000 | $1,000,000 |
| Total Depreciable Property | $1,000,000 | $1,100,000 | $1,100,000 |
| In Michigan | 300,000 | 400,000 | 300,000 |
| Outside Michigan | 700,000 | 700,000 | 800,000 |
| SBT Property Factor | .3 | .364 | .273 |
| Payroll Factor | .3 | .3 | .3 |
| Sales Factor | .5 | .5 | .5 |
| Apportionment Factor | .46 | .466 | .457 |
| Apportioned Tax Base | $460,000 | $466,364 | $457,272 |
| Apportioned CAD | $0 | $46,636 | $0 |
| Adjusted Tax Base | $460,000 | $419,727 | $457,272 |
| Tax (2.3% Rate) | $10,580 | $9,654 | $10,517 |
| Effective Tax Rate (Tax divided by Apportioned Tax Base) | 2.3% | 2.07% | 2.3% |

DISCRIMINATORY ADVANTAGE OF IN-STATE INVESTMENT: 0.23% AND $863.

*Boston*, 429 U.S. at 331. Director Heideman admitted that the CAD provided an incentive or influence to make investments in Michigan versus other states. Exhibit 4 at 48. This is because a taxpayer which chooses to situate property outside of Michigan must pay a higher effective SBT rate due to the CAD than if it chooses to place property in Michigan. The CAD penalizes taxpayers that choose to locate depreciable property outside of Michigan. It violates the "fundamental command" of the Commerce Clause, to wit: that a state "may not discriminate between transactions on the basis of some interstate element." *Armco*, 467 U.S. at 642.

In its Brief to the Court below, the Department *admitted* that "the CAD reduces the effective tax rate for any taxpayer making [an investment in Michigan]." Department's Brief at 20; 23. This admission recalls the state tax scheme stuck down in *Westinghouse*, *supra*. There, the Court found a Commerce Clause violation *precisely because the local tax benefit had the very effect* of decreasing a company's "effective New York tax rate" as its subsidiary did a greater percentage of its business in New York). *See* 466 U.S. at 401, n. 9 Table A.[8]

[8] For multistate businesses, total SBT liability would decrease with investment in Michigan. This is so because, for 1997, the SBT apportionment factor was computed by weighting the property factor by only 10%. Therefore, increases in Michigan property have only a small effect on the average apportionment factor and consequently, SBT liability. This effect will be even smaller for tax years after 1998 because the property factor is only weighted 5% for years 1999 and onward. *See* MICH. COMP. LAWS ANN. § 208.45a(1) (West 1998). App. 40. The decreasing weight given the property factor also shows that the site-based CAD is not related to any possible increase in SBT liability resulting from locating property in Michigan.

**The CAD Results In Multiple Taxation Of Out-of-State Assets, Thus Penalizing Taxpayers For Locating Capital Assets Outside Of Michigan**

The discriminatory effect of the CAD is apparent when one considers that a taxpayer who acquires property outside the state of Michigan is not taxed only once, but twice on such property. The SBTA taxes the consumption (*i.e.*, use) of productive resources of society. *Mobil Oil Corp. v. Michigan Dep't of Treasury*, 373 N.W.2d 730 (Mich. 1985). One such use of resources is the consumption of capital assets. Accordingly, depreciation of capital goods must be included in the taxpayer's SBTA tax base. MICH. COMP. LAWS ANN. § 208.9(4)(c) (West 1998); App. 30.

A VAT recognizes that capital goods are first produced and acquired by an enterprise (investment), and are then used up in the production of other goods (depreciation). *Mobil,* 373 N.W.2d at 496, n.14. The SBTA allows a deduction (the CAD) upon the acquisition of capital assets, but then adds back and taxes the depreciation of those assets. *Trinova,* 498 U.S. at 364 n.1. In doing so, the SBTA accomplishes its objective of taxing the use of resources. In *Mobil*, the Michigan Court recognized that the CAD and the add back of depreciation contained in the SBTA work hand-in-hand to prevent the double taxation of capital assets. Both an income-type VAT and consumption-type VAT require special treatment of capital to avoid taxing it twice. *Mobil,* 373 N.W.2d at 741, n.14.

When the SBTA was amended in 1995 to make the CAD site-based, the depreciation add-back provision was not amended. Thus, a taxpayer who places a capital asset in another state cannot take a CAD when that asset is acquired, but that taxpayer must add back the depreciation on the asset to its SBT tax base as the depreciation occurs. The result is that all multistate taxpayers actually pay more SBT *solely because they choose to acquire depreciable assets in other states*. Pomp Affidavit at ¶ 10. This discriminates against taxpayers who invest in out-of-state capital assets because such taxpayers are taxed twice on the assets (*i.e.*, once when they acquire the assets and

again when they add back the depreciation on the assets). A multistate taxpayer that invests in assets within Michigan's borders does not get taxed twice on the assets. A multistate taxpayer that chooses to locate capital assets in Ohio, for example, may pay more Michigan SBT in subsequent years solely because it chose to locate the assets in Ohio. This is demonstrated in Table 3, which was taken from the Affidavit of Professor Richard D. Pomp.[9]

Thus, the CAD and the depreciation addback work in tandem as a carrot and a stick: The CAD as a carrot ("invest in Michigan and you will get a deduction") and the depreciation add-back as a stick ("invest elsewhere and you will pay more Michigan taxes"). This blatant discrimination against interstate commerce violates the fundamental purpose of the Commerce Clause "to create an area of free trade among the several states." *Great Atlantic & Pacific Tea Co. v. Cottrell*, 424 U.S. 366, 370 (1976).

[9]

**TABLE 3**

**PENALTY FOR INVESTING IN OTHER STATES**

| | BEFORE $100,000 OHIO INVESTMENT | AFTER $100,000 OHIO INVESTMENT |
|---|---|---|
| Total SBT Tax Base | $1,000,000 | $1,006,667* |
| Total Depreciable Property | $1,000,000 | $1,100,000 |
| In Michigan | 0 | 0 |
| Outside Michigan | 1,000,000 | 1,100,000 |
| SBT Property Factor | 0% | 0% |
| Payroll Factor | 1% | 1% |
| Sales Factor | 20% | 20% |
| Apportionment Factor | 16.1% | 16.1% |
| Apportioned Tax Base | $161,000 | $162,073 |
| Apportioned CAD | $0 | $0 |
| Adjusted Tax Base | $161,000 | $162,073 |
| Tax (2.3% Rate) | $3,703 | $3,727.69 |

*Assuming the $100,000 investment is depreciated by using a 15-year straight line depreciation of $6,667 per year.

**Through The CAD, Michigan Improperly Uses Its Power To Tax As A Means To Require Additional Business Operations To Occur Within The State**

In *Boston*, the Court said that a state may not exercise its power to tax a particular event in such a way that it requires other business operations to be performed in the state. 429 U.S. at 321, n.4. The Court held that the imposition of a heavier tax burden on out-of-state sales of stock was an attempt by New York to require that such sales be performed in New York.

> New York's discriminatory treatment of out-of-state sales is made possible only because some other taxable event (transfer, delivery, or agreement to sell) takes place in the State. Thus, the State is using its power to tax an in-state operation as a means of "requiring [other] business operations to be performed in the home State." As a consequence, the flow of securities sales is diverted from the most economically efficient channels and directed to New York. This diversion of interstate commerce and diminution of free competition in securities sales are wholly inconsistent with the free trade purpose of the Commerce Clause.

*Id.* at 336.

The CAD uses precisely this sort of pressuring technique. Once a multistate business enterprise becomes subject to the single business tax, the CAD requires other business operations to be performed in Michigan. If they are not, the multistate taxpayer suffers a higher effective tax rate being imposed by Michigan on business operations conducted elsewhere. The taxpayer can only avoid this discrimination by altogether refusing to conduct business activity in Michigan, or succumb to the discrimination and locate more and more of its assets there. The CAD mechanism threatens to increase the burden on the multistate taxpayer when it chooses to conduct what may be more economically efficient operations at a location outside

of Michigan. This same diversion of interstate commerce and diminution of free competition was found to be wholly inconsistent with the free trade purpose of the Commerce Clause in *Boston*.[10]

**The CAD Was Enacted For A Discriminatory Purpose**

In determining the purpose behind discriminatory legislation, the Court has looked at legislative history, the identity of the interest groups backing the legislation, and the discriminatory nature of the legislation. In this case, Petitioner introduced evidence of all three.

**Legislative History.** In finding discriminatory purpose behind the tax provision at issue in *Bacchus*, the Court quoted legislative history and concluded that "we need not guess at the legislature's motivation, for it is undisputed that the purpose of the exemption was to aid Hawaiian industry." 468 U.S. at 271. Petitioner proved that the discriminatory purpose of the 1995 Amendments to the SBTA was virtually identical to the discriminatory purpose struck down in *Bacchus*. Two June 14, 1995 Memoranda to the House Tax Policy Committee from David White, a member of the House Republican programs and research staff, demonstrate that the impetus behind the legislation amending the CAD was to "provid[e] a tax cut for Michigan-based businesses by shifting a greater portion of the SBT burden to out-of-state businesses." Exhibits 9 and 10. The November 29, 1995 House Legislative Analysis of the Bill amending the CAD reveals that the purpose of the legislation was to "keep[ ] business and industry in the state [of Michigan]" and to "protect and favor" Michigan businesses. Exhibit 7 at 4. The improper

[10] If Petitioner had located in Michigan all 1997 capital assets it placed in service, Petitioner's total 1997 SBT liability would have been *reduced* by approximately $59,000. Exhibit 14 at ¶ 5.

purpose behind the CAD is also revealed by other amendments to the SBTA tie-barred to the CAD; specifically, companion legislation amending the SBTA apportionment formula (increasing the weight of the sales factor and decreasing the weight of the property and payroll factors). It was projected that changes to the apportionment formula would decrease Michigan Tax revenues, but this decrease would be offset or mitigated by the increased Michigan revenues generated by the CAD, according to statements by Rep. Perricone (Exhibit 12 at 2); changes to the CAD "will help offset revenue losses if you're going to a higher sales factor"; "with the [site-based CAD] . . . there should be no impact on revenues with the changes to the apportionment formula"). It is undeniable that the taxpayers who enjoy a reduced SBT burden from the changes in the apportionment formula are firms with a major physical presence (*i.e.*, property and payroll) in Michigan. Exhibit 5, pp. 5 and 6 of the May 27, 1999 Deposition of Mr. Mark Haas, Director of the Office of Revenue and Tax Analysis of the Department. Given the Legislature's intent on using the CAD to offset revenue losses from the apportionment changes, it is clear that the purpose of the Legislature in passing the CAD was to export tax burdens and import tax revenues in violation of the Commerce Clause.[11]

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[11] The Legislature was continually warned of the discriminatory nature of the CAD amendments. For instance, the House Republican Bill Analysis dated December 19, 1995 (given to all House Republicans) pointed out the constitutional problem with the CAD. The memo stated:

> *On its face, it [the site-based CAD] conspicuously discriminates against out-of-state businesses engaged in interstate commerce.* Furthermore, even though companies cannot receive an apportioned CAD for their out-of-state property, they must still add back their depreciation on out-of-state assets to determine their apportioned tax base. By permitting companies with a physical presence in Michigan to offset that annual depreciation addback with an apportioned CAD and then prohibit out-of-state companies from doing the same may be unconstitutionally discriminatory as well.

(Continued on following page)

**The Interest Groups.** Furthermore, the identity of the interest groups backing the 1995 legislation that contained the site-based CAD corroborates the legislative intent to discriminate against interstate commerce. The Michigan House and Senate legislative analyses indicate that the amendment was supported by the Michigan Manufacturers Association, Michigan State Chamber of Commerce and other local interests. Exhibits 7 and 8. In *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333 (1977), a case involving a challenge to a facially neutral statute regulating apple labeling, the Court noted that a discriminatory purpose was shown by a memorandum indicating that local apple producers were "mainly responsible for this legislation being passed." 432 U.S. at 352.

The Court below blithely dismissed Petitioner's contention that the CAD was enacted for a discriminatory purpose by asserting that the Legislature merely wished to encourage investment in Michigan and that this was a "laudatory goal." App. 9. This is not the test. If it were, no state tax would ever be struck down due to discriminatory intent. As the Court has said: "the promotion of domestic business" is "logically the primary reason for enacting discriminatory taxes such as those at issue here." *Metropolitan Life Ins. Co.*, 470 U.S. at 879 n.7. In *Bacchus*, *supra*, the Court specifically rejected the rationale adopted by the Court below: "No one disputes that a State may enact laws pursuant to its police powers that have the purpose and effect of encouraging domestic industry. However, the Commerce Clause stands as a limitation on the means by which a State can constitutionally seek to achieve that goal." *Bacchus*, 468 U.S. at 271. The Court went on:

> We also find unpersuasive the State's contention that there was no discriminatory intent on the

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Exhibits 9 and 10; *also* Exhibit 21, Scott Schrager memo to House Tax Policy Committee.

> part of the legislature because 'the exemptions in question were not enacted to discriminate against foreign products, but rather, to promote a local industry.' If we were to accept that justification, we would have little occasion ever to find a statute unconstitutionally discriminatory.

*Bacchus*, 468 U.S. at 273.

Similarly, in *Boston*, the Court held that "no State may, consistent with the Commerce Clause, build up its domestic commerce by means of unequal and oppressive burdens upon the industry and business of other States." 429 U.S. at 335 *quoting Baldwin v. GAF Seelig, Inc.*, 294 U.S. 511 (1935).

In *Boston*, the Court held:

> Our decision today does not prevent the states from structuring their tax systems to encourage the growth and development of intrastate commerce and industry. Nor do we hold that a State may not compete with other States for a share of interstate commerce; such competition lies at the heart of a free trade policy. We hold only that in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State.

429 U.S. at 336-337.

In virtually every case in which the Court has struck down a tax as discriminatory the state in question has argued that it was "merely promoting local business." The Court below was wrong to justify the CAD by this rationale.

The foregoing demonstration of facial discrimination and discriminatory effect of the CAD also demonstrates a discriminatory purpose. The CAD is facially discriminatory, has a discriminatory effect, and was enacted for a discriminatory purpose and, for these reasons, the CAD operates in violation of the Commerce Clause.

## CONCLUSION

A grant of certiorari in this case and a determination that the CAD violates the Commerce Clause would certainly come as no surprise to the Michigan Legislature. After all, although the Legislature suspected the constitutional invalidity of the CAD, it nonetheless determined to enact it at the behest of local interests, but not before inserting the "fall back" provisions that specify the remedy to be applied by the Court in the event of a finding of unconstitutionality. Inclusion of the fall back provisions was caused, no doubt, by Michigan's prior attempt to provide a direct commercial advantage to local business by utilizing the CAD provisions to create a preferential trade area within the state of Michigan. The CAD found by the Michigan Court of Claims and the Michigan Court of Appeals to be unconstitutional in the early 1990s was replaced by the 1991 enactment of nondiscriminatory CAD provisions applying equally to business operations conducted both inside and outside of the state. The nondiscriminatory provisions were short lived, however, replaced by the 1995 CAD amendments that are the subject of this case. The Michigan experience of enacting a discriminatory provision subsequently declared invalid; repealing that provision; replacing it with a nondiscriminatory provision; and then enacting another discriminatory provision, which like its predecessor, is held unconstitutional, continues to this day. The CAD challenged in this case has been replaced with an investment tax credit provision effective January 1, 2000, which, like its predecessor, requires that depreciable property be placed in service in Michigan in order to be eligible for the credit. The pattern of behavior by the state of Michigan over the last 25 years is clear: discriminate, litigate, legislate a different form of discrimination, litigate, legislate a different form of discrimination. Petitioner rightfully fears that until this Court speaks, Michigan will continue its pattern of churning one unconstitutional provision after another, attempting at all times to stay one step ahead of the judicial scrutiny that is so richly deserved.

For the foregoing reasons, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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March 11, 2003

**STATE OF MICHIGAN**

**COURT OF APPEALS**

| | |
|---|---|
| JEFFERSON SMURFIT CORPORATION,<br><br>Plaintiff-Appellee, | FOR PUBLICATION<br>November 13, 2001<br>9:00 a.m. |
| v | No. 224267<br>Court of Claims<br>LC No. 98-017140-CM |
| DEPARTMENT OF TREASURY,<br><br>Defendant-Appellant. | Updated Copy<br>January 18, 2002 |

Before: K.F. Kelly, P.J., and Murphy and Fitzgerald, JJ.

MURPHY, J.

Defendant Michigan Department of Treasury appeals as of right from an order of the Court of Claims that held unconstitutional MCL 208.23(e), the site-based capital acquisition deduction provision of the Single Business Tax Act (SBTA), MCL 208.1 *et seq.* The Court of Claims determined that the provision burdened interstate commerce and thus violated the Commerce Clause of the United States Constitution, art I, § 8, cl 3, in that both on its face and in its effect the provision operated in a discriminatory manner. We reverse.

The SBTA imposes a specific tax on the adjusted tax base of every person with business activity in this state that is allocated or apportioned to this state. MCL 208.31(1). The tax base is defined as business income subject to various adjustments. MCL 208.9(1). These adjustments convert an income tax to a value added tax and are designed to reflect business activity. The adjusted

tax base is then either allocated to Michigan, if business activities are confined solely to Michigan, MCL 208.40, or apportioned to Michigan, if the taxpayer's business activities are taxable both within and without the state. MCL 208.41.

The apportionment formula of the SBTA has repeatedly changed over the past two decades. In effect for 1997, the tax year at issue, the tax base was apportioned by multiplying that base by a percentage, which was the sum of the property factor multiplied by ten percent, the payroll factor multiplied by ten percent, and the sales factor multiplied by eighty percent. MCL 208.45(5). [1] Once a taxpayer's apportioned tax base is calculated, it is subject to additional adjustments before the specific tax rate provided by MCL 208.31(1) is applied. The adjustment here at issue is the capital acquisition deduction (CAD) contained in MCL 208.23.

As originally enacted in 1975, the SBTA computed the CAD for real and personal property differently. 1975 PA 228, § 23. The CAD for real property was limited to property located in Michigan and allowed for a full deduction. 1975 PA 228, subsection 23(c). The CAD for tangible personal property was apportioned to Michigan by multiplying the cost of all tangible personal property acquired during the year "by a fraction, the numerator of which is the payroll factor plus the property factor and the denominator of which is 2." 1975 PA 228, subsection 23(a). Both

[1] Each of the individual contributing factors – property, payroll, and sales – are fractions reflecting the ratio of Michigan activity to out-of-state activity: i.e., Michigan property/total property. See MCL 208.46, 208.49, 208.51.

aspects of the CAD were challenged on constitutional grounds in *Caterpillar, Inc v Dep't of Treasury,* 440 Mich 400 488 NW2d 182 (1992), cert den 506 US 1014 (1992). Subsection 23(a) was challenged on the basis that the apportionment formula was composed of only two factors, property and payroll, while the tax base was apportioned with the three-factor formula that additionally took into account sales. Subsection 23(c) was challenged on the basis that it was unconstitutional to limit the CAD to real property located in Michigan. The Court upheld both aspects, the four-justice majority ruling that neither component violated the Commerce Clause. *Caterpillar, supra* at 429.

Though the CAD provisions were upheld, while *Caterpillar* was pending on appeal before the Michigan Supreme Court the Legislature acted in response to this Court's intermediate ruling in the case. See *Caterpillar, Inc v Dep't of Treasury,* 188 Mich App 621 470 NW2d 80 (1991). With 1991 PA 77 and 1991 PA 128, the Legislature amended the statute to allow a CAD for the apportioned cost of both real and tangible personal property located within and without Michigan, using an identical apportionment formula as was used to calculate the apportioned tax base. See MCL 208.23(c) and (d).[2] Notwithstanding our Supreme Court's subsequent decision validating the original structure, the amended 1991 version of the CAD

[2] The then effective, but identically applied, apportionment formula provided for a percentage that was the sum of the property factor multiplied by twenty-five percent, the payroll factor multiplied by twenty-five percent, and the sales factor multiplied by fifty percent. MCL 208.45(4).

provisions remained effective for five years. That version of the statute went unchallenged.

In 1995, however, the Legislature again amended the CAD and apportionment provisions of the SBTA. Pursuant to 1995 PA 282, for the tax years between January 1, 1997, and December 31, 1998, taxpayers could utilize a site-specific CAD. MCL 208.23(e). Subsection 23(e) directed that this deduction for real and personal property located in Michigan was to be apportioned using the ten percent – ten percent – eighty percent formula provided by MCL 208.45(5). See 1995 PA 283. With the 1995 amendments, the Legislature included "fall-back" provisions. Pursuant to MCL 208.23a, if subsection 23(e) is "declared unconstitutional in a decision rendered by an appellate court and if that decision is not under appeal," subsection 23(e) and various other provisions become ineffective. In their place, MCL 208.23(i) takes effect to allow a CAD for the apportioned cost of tangible assets located within and without Michigan. The apportionment formula to be effective under such circumstance is the twenty-five percent – twenty-five percent – fifty percent formula provided by MCL 208.45(4). Essentially, the fall-back provisions render the CAD statutory structure for tax years 1997 and 1998 identical to the version in effect between 1991 and 1996, which went unchallenged.[3]

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[3] In 1999 the Legislature yet again amended the SBTA. Effective for tax years beginning January 1, 2000, both the site-specific and fall-back capital acquisition deduction provisions expire. See MCL 208.23 as amended by 1999 PA 115. The legislation also phases out the SBTA, by reducing the tax rate of 2.3 percent by 0.1 percent a year, potentially ending the tax in twenty-three years. 1999 PA 115, § 3. Additionally, 1999 PA 115 adds to the SBTA an investment tax credit. For tax years

(Continued on following page)

Plaintiff, Jefferson Smurfit Corporation, is an Illinois corporation that manufactures and sells packaging materials. Plaintiff operates over 150 plants in thirty states, and during the year in question, 1997, transacted business in Michigan. During 1997, plaintiff placed in service within and without Michigan over $150 million of depreciable property. Property costing approximately $651,000 was located in Michigan. Plaintiff accordingly filed a tax return taking a CAD for the apportioned cost of those assets located in Michigan. Utilizing MCL 208.23(e) and MCL 208.45(5), the CAD amounted to approximately $21,000.

Subsequently, however, plaintiff filed an amended return utilizing the fall-back provisions of MCL 208.23(i) and MCL 208.45(4) and taking a CAD on the apportioned cost of its total assets acquired during 1997. Plaintiff's amended return, incorporating the alternate apportionment formula and an increased CAD, resulted in a significant decrease in its tax liability. In conjunction with the filing of that amended return, plaintiff initiated the instant action challenging the site-specific aspect of the CAD effective for tax years 1997 and 1998 as unconstitutional. Plaintiff contended that subsection 23(e) violates the Commerce Clause, US Const. art I, § 8, cl 3, because it burdens out-of-state businesses and thus discriminates

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beginning after December 31, 1999, the credit is available to all businesses that make qualified capital investments in Michigan. MCL 208.35a(1). The tax credit is computed by multiplying the total qualified capital investments in Michigan by 0.85 percent, this percentage then reduced proportionate to the tax rate reduction. MCL 208.35a(2).

against interstate commerce. The Court of Claims agreed with plaintiff, and defendant now appeals.

This case presents an issue of statutory construction that this Court reviews de novo. See *Brown v Michigan Health Care Corp,* 463 Mich 368, 374; 617 NW2d 301 (2000). Specifically, the question at issue concerns the constitutionality of MCL 208.23(e) in view of the negative or dormant aspect of the Commerce Clause, US Const, art I, § 8, cl 3, which prohibits state practices that discriminate against interstate commerce. See *Wyoming v Oklahoma,* 502 US 437, 454 112 S Ct 789; 117 L Ed 2d 1 (1992).

The framework for constitutional analysis is well established, and was effectively detailed by our Supreme Court in *Caterpillar, supra* at 413-415. A statute is presumed constitutional absent a clear showing to the contrary. *Lehnhausen v Lake Shore Auto Parts Co,* 410 US 356, 364; 93 S Ct 1001; 35 L Ed 2d 351 (1973). The presumption of constitutionality is especially strong with respect to taxing statutes. *Ludka v Dep't of Treasury,* 155 Mich App 250, 264 399 NW2d 490 (1986), citing *O'Reilly v Wayne Co,* 116 Mich App 582, 591-592; 323 NW2d 493 (1982). Furthermore, deference should be afforded state legislatures, which have great discretionary latitude in formulating taxes. See *Wisconsin v JC Penney Co,* 311 US 435, 444-445; 61 S Ct 246; 85 L Ed 267 (1940). A taxing statute must be shown to "clearly and palpably violate [ ] the fundamental law" before it will be declared unconstitutional. *O'Reilly, supra* at 592, quoting *American Amusement Co Inc v Dep't of Treasury,* 91 Mich App 573, 577; 283 NW2d 803 (1979), quoting *Thoman v Lansing,* 315 Mich 566, 577; 24 NW2d 213 (1946), quoting others (internal quotation marks omitted).

As indicated by our Supreme Court in *Caterpillar, supra* at 415, the United States Supreme Court has

> established a four-pronged test to determine whether a state tax violates the Commerce Clause. *Complete Auto Transit, Inc v Brady,* 430 US 274, 279; 97 S Ct 1076; 51 L Ed 2d 326 (1977). A state tax will withstand scrutiny under a Commerce Clause challenge and will be held to be constitutionally valid under the four-pronged test articulated in *Complete Auto* provided that the tax: (1) is applied to an activity having a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the state.[26]

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[26]Since the *Complete Auto* decision, the four-pronged test has been applied on numerous occasions. See, e.g., *Trinova* [*Corp v Michigan Dep't of Treasury,* 498 US 358; 111 S Ct 818; 112 L Ed 2d 884 (1991)]; *Goldberg v Sweet,* 488 US 252; 109 S Ct 582; 102 L Ed 2d 607 (1989); *Amerada Hess Corp v New Jersey Dep't of the Treasury,* 490 US 66; 109 S Ct 1617; 104 L Ed 2d 58 (1989); *American Trucking Ass'ns, Inc v Scheiner,* [483 US 266; 107 S Ct 2829; 97 L Ed 2d 226 (1987)]; *Maryland v Louisiana,* 451 US 725; 101 S Ct 2114; 68 L Ed 2d 576 (1981).

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At issue here is the third prong of the *Complete Auto* test. Under that prong, a state tax scheme will be deemed unconstitutional if it (1) is facially discriminatory against interstate commerce, (2) has a discriminatory effect, or (3) was enacted for a discriminatory purpose. *Amerada Hess, supra* at 75. The Court of Claims held that "MCL

208.23(e), the site-based capital acquisition deduction to Michigan's single business tax, discriminates both on its face and in its effect on interstate commerce."

With respect to the first question, whether the CAD provision, subsection 23(e), exhibits facial discrimination, our Supreme Court's *Caterpillar* decision is instructive. There, in consideration of the site-specific real property CAD available pursuant to subsection 23(c), the Court noted that "[t]he CAD is available for any taxpayer, whether a multistate company or a company whose business activity is allocated entirely to Michigan – an in-state company." *Caterpillar, supra* at 422. Thus, held the Court, the plaintiff, Caterpillar, could not "point to any treatment of in-state and out-of-state companies that [was] discriminatory on its face." *Id.* at 422-423. Here, the site-specific CAD for real and personal property is likewise available to any and all companies doing any measure of business in Michigan. Accordingly, we conclude that subsection 23(e) is facially neutral.

Before contemplating the potential of discriminatory effect, we briefly address the question whether subsection 23(e) was enacted for a discriminatory purpose. Although plaintiff contends a discriminatory purpose is indicated by particular legislative commentary at the time of consideration of the 1995 amendments, we do not share plaintiff's interpretation of the referenced dialogue. To the contrary, we believe that such discussions regarding the goal of encouraging investment in Michigan fall in line with repeatedly approved intent and practice:

> It is a laudatory goal in the design of a tax system to promote investment that will provide jobs and prosperity to the citizens of the taxing State. States are free to "structur[e] their tax

> systems to encourage the growth and development of intrastate commerce and industry." [*Trinova, supra* at 385-386, quoting *Boston Stock Exchange v State Tax Comm,* 429 US 318, 336; 97 S Ct 599; 50 L Ed 2d 514 (1977).]

The Legislature's intent being legitimate, what remains to be considered is whether such a laudatory goal is achieved without discriminatory effect.

States may compete with one another for a share of interstate commerce, they just may not discriminatorily tax the products manufactured or the business operations performed in other states. *Boston Stock Exchange, supra* at 336-337. Here, the CAD is available to all Michigan taxpayers who locate new property in Michigan, whether intrastate or multistate businesses, and it is available at the same apportioned rate as is applied to the taxpayer's overall tax base. The three-factor apportionment formula of the SBTA has survived constitutional challenge, see *Trinova, supra* at 387, and the availability of an apportioned CAD in a given tax year is not dependent on the initial location of the taxpayer's assets, but rather turns on the taxpayer's election to increase its Michigan investment.

We conclude, therefore, that the CAD provision is not designed to punish multistate taxpayers who choose not to increase their Michigan presence. Moreover, we are not convinced that the CAD provision is responsible for any deleterious effects suffered by multistate taxpayers who opt to increase activity outside Michigan. Accordingly, we note agreement with an analysis adopted by our Supreme Court in *Caterpillar, supra* at 425:

> "Generally speaking, the overall tax consequences to a multistate taxpayer will be dependent upon the nature of its business activities and whether it is eligible and elects to avail itself of the tax reduction incentives afforded by the [SBT]." [Pollock, *Multistate taxpayers under the Single Business Tax Act,* 22 Wayne L R 1101, 1113 (1976).]

We hold that the site-specific CAD available pursuant to subsection 23(e) has no discriminatory effect on interstate commerce.

Contrary to the Court of Claims, we hold that plaintiff has failed to carry its burden of demonstrating that the challenged provision clearly and palpably violates the fundamental law. *Thoman, supra* at 576, *O'Reilly, supra* at 592. We find no clear showing of illegitimacy sufficient to overcome the strong presumption of constitutionality accorded this provision of Michigan's single business tax scheme. See *Lehnhausen, supra; Ludka, supra.*

Reversed.

/s/ William B. Murphy
/s/ Kirsten Frank Kelly
/s/ E. Thomas Fitzgerald

**Court of Appeals, State of Michigan**

**ORDER**

| | |
|---|---|
| Jefferson Smurfit Corp v. Dept of Treasury | Kirsten Frank Kelly Presiding Judge |
| Docket No. 224267 | William B. Murphy |
| LC No. 98-017140 | E. Thomas Fitzgerald Judges |

The Court orders that the motion for rehearing is DENIED.

/s/ Kirsten F. Kelly
Presiding Judge

[SEAL]

A true copy entered and certified by Sandra Schultz Mengel, Chief Clerk, on

JAN 11 2002
Date

/s/ Sandra Schultz Mengel
Chief Clerk

STATE OF MICHIGAN
IN THE COURT OF CLAIMS

JEFFERSON SMURFIT
CORPORATION (US)

Plaintiff,

File No.
98-17140-CM

-v-

REVENUE DIVISION,
DEPARTMENT OF TREASURY,
STATE OF MICHIGAN,

Defendant.

_____/

MOTION FOR SUMMARY DISPOSITION

BEFORE THE HONORABLE MICHAEL G. HARRISON, CIRCUIT COURT JUDGE MASON, MICHIGAN – WEDNESDAY, NOVEMBER 24, 1999

APPEARANCES:

For the Plaintiff:

PATRICK R. Van TIFLIN (P-26119)
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For the Defendant:

GLENN R. WHITE (P-53520)
Assistant Attorney General
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Lansing, MI 48922

Reported by:

Jody A. Larsen, CSR-4224
Official Court Reporter

* * *

[2] Mason, Michigan

Wednesday, November 24, 1999

9:26 a.m., approximately

RECORD

THE COURT: All right. The matter before the Court is *Jefferson Smurfit* versus *The Department of Treasury,* Docket 17140. I have a Motion for Summary Disposition.

I have reviewed your briefs, so if you would please proceed accordingly I would appreciate it.

MR. WHITE: Thank you, your Honor. Glenn White for The Department of Treasury. My briefs will be – my remarks will be fairly brief.

Three points I would like to make, your Honor. The first one is that the allegation here is that the – by the plaintiff is that the site-specific capital acquisition deduction is unconstitutional because it places an impermissible burden on interstate commerce.

Both parties have discussed the case of *Caterpillar* versus *The Michigan Department of Treasury,* 440 Mich 400, a 1992 case, in which the Michigan Supreme Court found that a site-specific capital acquisition deduction was constitutional and only distinguished between investments made in Michigan and those made in other states. It did not find that a [3] site-specific capital acquisition deduction was unconstitutional.

That decision was passively endorsed by the United States Supreme Court when it failed or refused to grant cert on appeal.

The second point I'll make is that the capital acquisition deduction compensates businesses that invest in Michigan because an investment in Michigan will raise its single business tax liability.

The hypothetical on page 13 of plaintiff's brief accurately demonstrates that in one year of investment the business investing in Michigan will realize a $300 tax savings. However, in subsequent years that business's Michigan tax liability will be increased by a little over $200 and – over a like business that invests in Ohio.

Now, the effect – that's based on the effect of apportioning, of course, or business activity based on a property factor. And the effect of the tax savings of the earned investments will be eliminated two years – the two subsequent years of the – following the investments.

The effective tax rate based on the total tax base on the hypothetical would be .51 percent for the business that invests in Michigan and would be .49 percent for the business that invests in Ohio. And that points out that if you look at the total tax base versus the [4] apportioned tax base, there is a higher effective tax rate. If you look at the apportioned tax base, as plaintiff accurately states, there is a lower effective rate for the year of investment and the same tax rate thereafter.

My final point is that this is purely a legal issue, that there is no disputed facts, and that this is – this case is ripe for judgment.

As this Court noted in July, the Court stated that the statute either rises or falls on its own weight based on the plain reading of the language itself.

For the reasons stated in defendant's brief we ask that the Court grant its Motion for Summary Disposition under MCR 2.116 (C)(10) and to dismiss the complaint with prejudice and without costs.

On the other hand, if the Court finds that the statute is unconstitutional, we ask that you provide plaintiff judgment in its favor and grant its requested relief.

Thank you.

THE COURT: Thank you.

MR. Van TIFLIN: May it please the Court, Patrick Van Tiflin from Honigman, Miller, Schwartz and Cohn, appearing this morning before the Court on behalf of the plaintiff, Jefferson Smurfit.

[5] As a preliminary matter, I think I should probably observe that I guess I've lived long enough, because I don't think I've ever before had any representative of the Attorney General's Office ask the Court to grant summary disposition in my favor on any basis whatsoever.

THE COURT: You notice they never pay the motion fee.

MR. Van TIFLIN: That is exactly right.

THE COURT: They piggyback on yours.

MR. Van TIFLIN: I feel like I've been used, but in a genteel way.

MR. WHITE: We paid the motion fee this time, your Honor.

MR. Van TIPLIN: I think that – that certainly our principal brief and the supporting exhibits adequately set forth our – the reasons for which we believe that the defendant's motion should be denied. There was a reply brief that was filed. And I would like to simply address a couple of points that were raised in that reply brief for my argument this morning.

First of all, at page 4 of defendant's reply brief the defendant asserts that there can be no dispute that an unapportioned, site-based CAD is constitutional in Michigan under *Caterpillar*. That conclusion is [6] incorrect for several reasons.

First of all, as we demonstrated in our initial brief, an unapportioned –

THE COURT: I just went through CAD for the last few weeks, but that's called computer aided design.

MR. Van TIFLIN: That's correct, Your Honor. Recognizing computer literacy abounds here, I should be specific, CAD, in the context of the capital acquisition deduction. It is incongruous that an unapportioned, site-based CAD can be constitutional in Michigan and yet, under existing US Supreme Court cases cited in our brief, would be unconstitutional everywhere else in the country.

Secondly, the *Caterpillar* decision of the Michigan Supreme Court needs to be read in the light of and in the context of the US Supreme Court's decisions in *Boston, Westinghouse,* and *Hunt* that we've cited in our initial brief.

I do have to take issue with the representation that the US Supreme Court's denial of certiorari in the *Caterpillar* case represents any sort of a passive endorsement. As the Court knows, denial of certiorari imports no expression of opinion upon the merits of a case according to the US Supreme Court decisions in *Carver* and *Teague*.

Finally, *Caterpillar* involved an unapportioned [7] capital acquisitional deduction that was site specific. This case involves an apportioned capital acquisition deduction that is site specific. And as demonstrated in our brief, it discriminates against interstate commerce and lacks the consistency that is required when it's drawn into question as far as its impact on interstate commerce.

In fact, on page 4 of their brief the Department admits that Caterpillar is controlling because it recognizes this distinction between an apportioned capital acquisition deduction that is site specific and an unapportioned, site-specific capital acquisition deduction.

Secondly, the Department asserts in their reply brief there are no factual issues that the Court would need to resolve in an evidentiary hearing or trial. That really ignores the fact that this is the plaintiff's case. As we point out in our brief the plaintiff, in order to prevail in this case, can demonstrate either of three things: First, that the statute facially discriminates against interstate commerce; secondly, that it has a discriminatory effect; and thirdly, that it was enacted for a discriminatory purpose.

The plaintiff desires to prove all three prongs of those challenges to the statute. And they are essentially factual questions.

[8] Now, it is true that we have attached to our brief in opposition to defendant's motion many of the materials that have been produced through discovery. It is also true that the Department has blocked our ability to take the testimony of a key witness, an employee of the Department of Treasury, who was the deputy treasurer for legislative affairs involved in negotiating this – these amendments in 1995 when they were going through statute – the legislature. And it is also true that the defendant has refused to turn over to us some 25 documents that have been identified as having some bearing on this case.

So for those reasons we ask that you deny the defendant's Motion for Summary Disposition and allow this matter to proceed to trial for an orderly disposition.

Thank you.

THE COURT: Rebuttal, please.

MR. WHITE: Just the point on the factual issues remaining. This is a legal question on the – whether a statute's constitutional. And the intent of the legislature is governed by the plain language of the statute. It's for this Court to determine whether it's constitutional or not.

In the case of *Westinghouse* cited by plaintiff and defendant, the US Supreme Court examined legislative history. And the legislative history they looked at was [9] the language of the statute, the preamble to the statute, and the endorsing memorandum by Governor Rockefeller when he approved the questioned statute. Those are the kinds of things that the Supreme Court has looked at as far as legislative history, not employees of executive

branch or executive branch documents which are of little relevance, if any.

Thank you.

THE COURT: Defendant moves – and let me first preface my comments or my ruling with my appreciation for the briefs which were submitted. They were certainly very well done, and I thank you.

Defendant moves for summary disposition as to plaintiff's complaint pursuant to MCR 2.116(C)(10).

A motion under this subrule tests whether there is a question of material fact for trial. The Court must inquire whether the type of record which may be developed, giving the benefit of reasonable doubt to the opposing party, would leave open an issue upon which reasonable minds may differ. The Court examines the facts in the light most favorable to the nonmoving party.

The moving party must support the motion with affidavits or other documentary evidence. The opposing party may not rest upon mere allegations or denials in the pleadings, but must, by affidavit or other documentary [10] evidence, set forth specific facts showing there is a genuine issue for trial.

The Court begins its analysis from the position that the constitutionality of a statute is presumed, especially with respect to taxing statutes. *Caterpillar* versus *The Department of Treasury,* 440 Michigan 400, 1992.

A state tax will withstand scrutiny under a commerce clause challenge and will be held constitutionally valid provided the tax is applied to an activity having a substantial nexus with the taxing state, is fairly apportioned, does

not discriminate against interstate commerce, and fairly relates to the services provided by the state. *Caterpillar* at 416, citing *Complete Auto Transit, Incorporated* versus *Brady,* 430 US 274, 1977. I will not give the parallel cites.

In the instant matter plaintiff only raises a challenge as to the third prong. Although interstate commerce is not immune from state taxation, the Commerce Clause prohibits economic protectionism, that is, regulatory measures designed to benefit in-state competitors. *New Energy of Indiana* versus *Limbach,* 486 US 269, 1988.

A tax violates the third prong of the Complete Auto test if it is facially discriminatory, has a [11] discriminatory purpose, or has the effect of unduly burdening interstate commerce. *Caterpillar* at 442, citing *Amerada Hess Corporation* versus *The New Jersey Department of Treasury,* 490 US 66, 1989.

Plaintiff's complaint first argues that the site-based capital acquisition deduction is discriminatory on its face. By its own text, MCL 208.23(e), the capital acquisition deduction, is equally available to both in-state and out-of-state taxpayers, but only for capital assets located within the State of Michigan.

Prior to the 1995 amendments, the capital acquisition deduction was available for assets located within the state as well as assets outside of the state. A taxpayer's single business tax base was determined by the same apportionment formula, subject to a capital acquisition deduction, no matter where the asset was physically located. Thus, the decision where to place new assets was not influenced by the availability of the capital acquisition deduction. The flow of interstate commerce was channeled neither into nor out of Michigan by the deduction.

Since the 1995 amendments took effect, the deduction is only available to a taxpayer if the asset is located in the state. The obvious effect is to give an incentive and advantage to taxpayers to locate assets [12] within the State of Michigan. For multi-state taxpayers then the decision of where to place physical assets is now influenced by the amended deduction provision.

No state, consistent with the Commerce Clause, may impose a tax which discriminates against interstate commerce by providing a direct commercial advantage to local business. *Boston Stock Exchange* versus *The State Tax Commission,* 429 US 318, 1977, citing *Northwestern States Portland Cement Company* versus *Minnesota,* 358 US 450, 1959.

In the instant matter, in-state taxpayers are able to take advantage of the amended deduction while out-of-state taxpayers may only avail themselves of the deduction if they have capital assets physically located in the state. The effect is to channel capital investment into Michigan.

Defendant maintains that it is constitutionally permissible for a state to structure its tax system so as to encourage the growth and development of intrastate commerce. However, it seems clear that such growth and development is not to be had at the expense of inhibiting interstate commerce. See *Boston Stock Exchange, Northwestern States Portland Cement Company,* and *Complete Auto.*

In its brief defendant maintains that the [13] amended deduction reduces the effective tax rate for any taxpayer making such an investment. However, while a taxpayer which makes a capital investment in Michigan is

entitled to a one-time deduction under the capital acquisition deduction, that taxpayer is also saddled with a higher apportionment of its tax base for single business tax purposes in the current and succeeding years.

Therefore, an out-of-state taxpayer which invests elsewhere is not entitled to the one-time deduction but, by the same token, that taxpayer's apportionment of its tax base is not increased for single business tax purposes. In fact, a multi-state taxpayer's apportionment percentage may even decrease given rise to a reduced single business tax liability.

Plaintiff, as apart of its claim that the deduction is discriminatory on its face and in its effect, also argues that the deduction is not internally consistent because a multi-state taxpayer must also pay taxes in other states. Plaintiff argues that if every state enacted Michigan's single business tax, a multi-state corporation, with investments in Michigan and another state, would pay more tax than a corporation with all of its activities located within Michigan.

In *Container Corporation of America* versus *Franchise Tax Board,* 463 US 159, 1983, the Supreme Court [14] noted that a state tax must have what might be called internal consistency, that is, the tax must be such that if applied in every jurisdiction, there would be no impermissible interference with free trade.

Although *Container Corporation* was concerned with the issue of fair apportionment, the Supreme Court has also stated that a similar rule applies where the allegation is that a tax on its face discriminates against interstate commerce. *Armco, Incorporated,* versus *Hardesty,* 467 US 638.

The Court is satisfied that plaintiff has demonstrated that the deduction fails this internal consistency test. Plaintiff has demonstrated that under this analysis a multi-state taxpayer may be penalized for having operated in interstate commerce rather than strictly intrastate commerce.

A taxpayer operating in two states would be unable to take advantage of the full deduction due to the fact that the amount of the deduction which can be taken is determined by the apportionment of the taxpayer's activities in each state.

The Court is of the opinion that such a burden falls directly on free trade among the states and is impermissible under the Commerce Clause. Such an effect may result in the type of economic isolation among the [15] states which the Commerce Clause seeks to prevent. See *Oklahoma Tax Commission* versus *Jefferson Lines, Incorporated,* 115 S Ct 1331, 1995.

The defendant has not addressed this argument as articulated by plaintiff.

The Court is aware of defendant's reliance on *Caterpillar* and *Trinova* versus *Michigan Department of Treasury,* 498 US 358, 1991, in support of the constitutionality of the capital acquisition deduction.

However, the primary issue in *Caterpillar* was concerned with whether the lack of symmetry between the three-factor formula used for calculating the single business tax base and the two-factor formula used under the then-existing subsection 23(a) of the deduction rendered the deduction unconstitutional.

Further, the Court in *Caterpillar* did not engage in a commerce clause analysis of the deduction for real property as contained in the then-existing subsection 23(C).

The Court, therefore, is of the opinion that MCL 208.23(e), the site-based capital acquisition deduction to Michigan's single business tax, discriminates both on its face and in its effect on interstate commerce. Accordingly, the defendant's Motion for Summary Disposition is denied.

[16] The Court, based on the defendant's plea, will grant the motion in favor of the plaintiff and will approve an order accordingly.

MR. WHITE: I have one prepared, your Honor.

MR. Van TIFLIN: Apparently I have lived long enough. Not only is he asking for judgment in my favor, but he's got an order to that effect ready.

THE COURT: So it's a 50/50 day, isn't it, Mr. Van Tiflin?

MR. Van TIFLIN: Thank you, very much, your Honor. It could have been worse.

MR. WHITE: Thank you, your Honor.

MR. Van TIFLIN: Happy Thanksgiving.

THE COURT: Okay. Thank you all. Have a good Thanksgiving as well.

(Court recessed at approximately 9:59 a.m.)

* * *

[17] STATE OF MICHIGAN )
)
COUNTY OF INGHAM )

I certify that this transcript, consisting of 17 pages, is a complete, true, and accurate excerpt in the matter of *Jefferson Smurfit Corporation (US) v Revenue Division, Department of Treasury, State of Michigan,* Docket No. 98-171407-CM, held on Wednesday, November 24, 1999.

Dated: 12/5/99 /s/ Jody A. Larsen

STATE OF MICHIGAN
COURT OF CLAIMS

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JEFFERSON SMURFIT CORPORATION (U.S.),

Plaintiff, Case No. 98-17140-CM

v.

REVENUE DIVISION, DEPARTMENT OF TREASURY, STATE OF MICHIGAN, HON. MICHAEL G. HARRISON

Defendant.

---

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**AMENDED ORDER AND JUDGMENT**

At a session of said Court held in the Court of Claims, in Mason, Michigan, on the 13th day of December, 1999.

PRESENT: HONORABLE MICHAEL G. HARRISON
Judge of the Court of Claims

After a hearing on Defendant's Motion for Summary Disposition held on November 24, 1999 and for the reasons stated from the bench; NOW THEREFORE, pursuant to MCR 2.602(B)(2), IT IS HEREBY

ORDERED, that Defendant's Motion for Summary Disposition under MCR 2.116(C)(10) is DENIED and the Court hereby grants judgment in favor of Plaintiff pursuant to MCR 2.116(I)(2) for the relief requested in the Complaint; and it is

FURTHER ORDERED, that Defendant Michigan Department of Treasury refund to Plaintiff single business tax in the amount of $266,786 together with statutory interest.

This Order is a Final Judgment that resolves the last pending claim in this matter and CLOSES this case.

/s/ Michael G. Harrison
Honorable Michael G. Harrison
Judge of the Court of Claims

APPROVED AS TO FORM:

/s/ Patrick R. Van Tiflin
PATRICK R. VAN TIFLIN (P26119)
Honigman Miller Schwartz and Cohn
Attorneys for Plaintiff

/s/ Glenn R. White
GLENN R. WHITE (P53520)
Assistant Attorney General
Attorneys for Defendant

**Order**

**Entered:** December 11, 2002

**Michigan Supreme Court**
**Lansing, Michigan**

**Maura D. Corrigan,**
**Chief Justice**

**Michael F. Cavanagh**
**Elizabeth A. Weaver**
**Marilyn Kelly**
**Clifford W. Taylor**
**Robert P. Young, Jr.**
**Stephen J. Markman,**
**Justices**

120925

JEFFERSON SMURFIT CORPORATION,

Plaintiff-Appellant,

v

DEPARTMENT OF TREASURY,

Defendant-Appellee.

SC: 120925
COA: 224267
Court of Claims:
98-017140-CM

On order of the Court, the application for leave to appeal from the November 13, 2001 decision of the Court of Appeals is considered, and it is DENIED, because we are not persuaded that the questions presented should be reviewed by this Court.

[SEAL] I, CORBIN R. DAVIS, Clerk of the Michigan Supreme Court, certify that the foregoing is a true and complete copy of the order entered at the direction of the Court.

December 11, 2002 /s/ Inger Z. Meyer
Deputy Clerk

U.S. Const. art. 1, § 8

The Congress shall have power to . . . regulate commerce with foreign nations, and among the several states, and with the Indian tribes;

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Mich. Comp. Laws § 208.9 "Tax base" defined.

Sec. 9. (1) "Tax base" means business income, before apportionment or allocation as provided in chapter 3, even if zero or negative, subject to the adjustments in this section.

(2) Add gross interest income and dividends derived from obligations or securities of states other than Michigan, in the same amount that was excluded from federal taxable income, less the related portion of expenses not deducted in computing federal taxable income because of sections 265 and 291 of the internal revenue code.

(3) Add all taxes on or measured by net income and the tax imposed by this act to the extent the taxes were deducted in arriving at federal taxable income.

(4) Add the following, to the extent deducted in arriving at federal taxable income:

(a) A carryback or carryover of a net operating loss.

(b) A carryback or carryover of a capital loss.

(c) A deduction for depreciation, amortization, or immediate or accelerated write-off related to the cost of tangible assets.

(d) A dividend paid or accrued except a dividend that represents a reduction of premiums to policyholders of insurance companies.

(e) A deduction or exclusion by a taxpayer due to a classification as, or the payment of commissions or other fees to, a domestic international sales corporation or any like special classification the purpose of which is to reduce or postpone the federal income tax liability. This subdivision does not apply to the special provisions of sections 805, 809, and 815(c)(2)(A) of the internal revenue code.

(f) All interest including amounts paid, credited, or reserved by insurance companies as amounts necessary to fulfill the policy and other contract liability requirements of sections 805 and 809 of the internal revenue code. Interest does not include payments or credits made to or on behalf of a taxpayer by a manufacturer, distributor, or supplier of inventory to defray any part of the taxpayer's floor plan interest, if these payments are used by the taxpayer to reduce interest expense in determining federal taxable income. For purposes of this section, "floor plan interest" means interest paid that finances any part of the taxpayer's purchase of automobile inventory from a manufacturer, distributor, or supplier. However, amounts attributable to any invoiced items used to provide more favorable floor plan assistance to a taxpayer than to a person who is not a taxpayer is considered interest paid by a manufacturer, distributor, or supplier.

(g) All royalties except for the following:

(i) On and after July 1, 1985, oil and gas royalties that are excluded in the depletion

deduction calculation under the internal revenue code.

(ii) Cable television franchise fees described in section 622 of part III of title VI of the communications act of 1934, 47 U.S.C. 542.

(iii) Except as provided in subparagraph (iv), for the tax years 1986 and after 1986, a franchise fee as defined by section 3 of the franchise investment law, 1974 PA 269, MCL 445.1503, in the following amounts:

(A) For the tax years 1986, 1987, and 1988, 20% of the franchise fee.

(B) For the tax years 1989 and 1990, 50% of the franchise fee.

(C) For the tax years 1991 and after 1991, 100% of the franchise fee.

(iv) For the tax years ending before 1991, this subdivision does not apply to a fee for services paid by a franchisee that, with respect to a specific provision of a franchise agreement, a court of competent jurisdiction, before June 5, 1985, has determined is not a royalty payment under this act.

(v) Film rental or royalty payments paid by a theater owner to a film distributor, a film producer, or a film distributor and producer.

(vi) Royalties, fees, charges, or other payments or consideration paid or incurred by radio or television broadcasters for program matter or signals.

(vii) Royalties, fees, charges, or other payments or consideration paid by a film distributor for copyrighted motion picture films, program matter, or signals to a film producer.

(viii) For tax years that begin after December 31, 1993, royalties paid by a licensee of application computer software, operating system software, or system software pursuant to a license agreement. As used in this subparagraph and subsection (7)(c)(vii):

(A) "Application computer software" means a set of statements or instructions that when incorporated in a machine usable medium is capable of causing a machine or device having information processing capabilities to indicate, perform, or achieve a particular business function, task, or result for the nontechnical end user. Application computer software includes any other computer software that does not qualify under sub-subparagraph (B) or (C).

(B) "Operating system software" means a set of statements or instructions that when incorporated into a machine or device having information processing capabilities is an interface between the computer hardware and the application computer software or system software.

(C) "System software" means a set of statements or instructions that interacts with operating system software

that is developed, licensed, and intended for the exclusive use of data processing professionals to build, test, manage, or maintain application computer software for which a license agreement is signed by the licensor and licensee at the time of the transfer of the software and that is not transferred to the licensee as part of or in conjunction with a sale or lease of computer hardware.

(ix) For tax years that begin after December 31, 2000, royalties, fees, or other payments or consideration paid or incurred by a franchisee to a franchisor to establish or maintain the franchise relationship other than payments for the sale or lease of inventory, equipment, fixtures, or real property at fair rental or fair market value.

(h) A deduction for rent attributable to a lease back that continues in effect under the former provisions of section 168(f)(8) of the internal revenue code of 1954 as that section provided immediately before the tax reform act of 1986, Public Law 99-514, became effective or to a lease back of property to which the amendments made by the tax reform act of 1986 do not apply as provided in section 204 of the tax reform act of 1986.

(5) Add compensation.

(6) Add a capital gain related to business activity of individuals to the extent excluded in arriving at federal taxable income.

(7) Deduct the following, to the extent included in arriving at federal taxable income:

(a) A dividend received or considered received, including the foreign dividend gross-up provided for in the internal revenue code.

(b) All interest except amounts paid, credited, or reserved by an insurance company as amounts necessary to fulfill the policy and other contract liability requirements of sections 805 and 809 of the internal revenue code.

(c) All royalties except for the following:

(i) On and after July 1, 1985, oil and gas royalties that are included in the depletion deduction calculation under the internal revenue code.

(ii) Except as provided in subparagraph (iii), for the 1986 tax year and after the 1986 tax year, a franchise fee as defined in section 3 of the franchise investment law, 1974 PA 269, MCL 445.1503, in the following amounts:

(A) For the tax years 1986, 1987, and 1988, 20% of the franchise fee.

(B) For the tax years 1989 and 1990, 50% of the franchise fee.

(C) For the tax years 1991 and after 1991, 100% of the franchise fee.

(iii) For the tax years ending before 1991, this subdivision does not apply to a fee for services paid by a franchisee that, with respect to a specific provision of a franchise agreement, a court of competent jurisdiction, before June 5, 1985, has determined is not a royalty payment under this act.

(iv) Film rental or royalty payments paid by a theater owner to a film distributor, a film producer, or a film distributor and producer.

(v) Royalties, fees, charges, or other payments or consideration paid or incurred by radio or television broadcasters for program matter or signals.

(vi) Royalties, fees, charges, or other payments or consideration paid by a film distributor for copyrighted motion picture films, program matter, or signals to a film producer.

(vii) For tax years that begin after December 31, 1997, royalties received by a licensor, distributor, developer, marketer, or copyright holder of application computer software or operating system software pursuant to a license agreement. System software is not included within the exception under this subparagraph.

(viii) For tax years that begin after December 31, 2000, royalties, fees, or other payments or consideration paid or incurred by a franchisee to a franchisor to establish or maintain the franchise relationship other than payments for the sale or lease of inventory, equipment, fixtures, or real property at fair rental or fair market value.

(d) Rent attributable to a lease back that continues in effect under the former provisions of section 168(f)(8) of the internal revenue code of 1954 as that section provided immediately before the tax reform act of 1986, Public Law 99-514, became effective or to a lease back of property to

which the amendments made by the tax reform act of 1986 do not apply as provided in section 204 of the tax reform act of 1986.

(8) Deduct a capital loss not deducted in arriving at federal taxable income in the year the loss occurred.

(9) To the extent included in federal taxable income, add the loss or subtract the gain from the tax base that is attributable to another entity whose business activities are taxable under this act or would be taxable under this act if the business activities were in this state.

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Mich. Comp. Laws § 208.23 Adjustment of tax base.

Sec. 23. After allocation as provided in section 40 or apportionment as provided in section 41, the tax base shall be adjusted by the following:

* * *

(e) Except as provided in subdivisions (g),(h), and (i), for a tax year beginning after December 31, 1996 and before January 1, 2000, deduct the cost, including fabrication and installation, paid or accrued in the taxable year of tangible assets of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes, provided that the assets are physically located in this state for use in a business activity in this state and are not mobile tangible assets. This deduction shall be multiplied by the apportionment factor for the tax year as prescribed in chapter 3.

* * *

(i) For a tax year beginning after December 31, 1996 and before January 1, 2000 if subdivision (e) is not in effect, deduct the cost, including fabrication and installation, paid or accrued in the taxable year of tangible assets of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes. This deduction shall be multiplied by the apportionment factor for the tax year as prescribed in chapter 3.

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Mich. Comp. Laws § 208.23a Decision declaring § 208.23(e) unconstitutional; effect.

Sec. 23a. For a year for which any portion of section 23(e) is declared unconstitutional in a decision rendered by an appellate court and if that decision is not under appeal, sections 23(e), (f), (g), and (h), 23b(e) and (f), and 36c are not effective.

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Mich. Comp. Laws § 208.41 Apportionment of tax base; business activities taxable within and without state.

Sec. 41. A taxpayer whose business activities are taxable both within and without this state, shall apportion his tax base as provided in this chapter.

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Mich. Comp. Laws § 208.45 Apportionment of tax base to state.

* * *

(4) For tax years beginning after December 31, 1992 and before January 1, 1997 and for tax years beginning after December 31, 1996 and before January 1, 1998 if section 23(e) is not in effect, all of the tax base, other than the tax base derived principally from transportation, financial, or insurance carrier services or specifically allocated, shall be apportioned to this state by multiplying the tax base by a percentage, which is the sum of all of the following percentages:

(a) The property factor multiplied by 25%.

(b) The payroll factor multiplied by 25%.

(c) The sales factor multiplied by 50%.

(5) Except as provided in subsections (4) and (7) and for tax years beginning after December 31, 1996 and before January 1, 1999, all of the tax base, other than the tax base derived principally from transportation, financial, or insurance carrier services or specifically allocated, shall be apportioned to this state by multiplying the tax base by a percentage, which is the sum of all of the following percentages:

(a) The property factor multiplied by 10%.

(b) The payroll factor multiplied by 10%.

(c) The sales factor multiplied by 80%.

MCL 206.45a

Sec. 45a. (1) Except as provided in subsection (2) and for tax years beginning after December 31, 1998, all of the tax base, other than the tax base derived principally from transportation, financial, or insurance carrier services or specifically allocated, shall be apportioned to this state by multiplying the tax base by a percentage, which is the sum of all of the following percentages:

(a) The property factor multiplied by 5%.

(b) The payroll factor multiplied by 5%.

(c) The sales factor multiplied by 90%.

(2) For tax years beginning after December 31, 1998 and before January 1, 2000 if section 23(e) is not in effect, all of the tax base, other than the tax base derived principally from transportation, financial, or insurance carrier services or specifically allocated, shall be apportioned to this state by multiplying the tax base by a percentage, which is the sum of all of the following percentages:

(a) The property factor multiplied by 15%.

(b) The payroll factor multiplied by 15%.

(c) The sales factor multiplied by 70%.

(3) For purposes of this section, a taxpayer that has a 52- or 53-week tax year beginning not more than 7 days before December 31 of any year is considered to have a tax year beginning after December 31 of that year.